No. 10203

In the United States Circuit Court of Appeals for the Ninth Circuit

APARTMENT OPERATORS ASSOCIATION,
A CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

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CITATIONS

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OPINION BELOW

The opinion of the Board of Tax Appeals (R. 93–104) is reported at 46 B. T. A. 229.

JURISDICTION

This petition for review (R. 105–108) involved federal income and excess profits taxes for the taxable year 1938. On December 16, 1940, the Commissioner of Internal Revenue mailed to the taxpayer notice of a deficiency in the total amount of $210.68. (R. 3–4.) Within ninety days thereafter and on March 17, 1941, the taxpayer filed a petition with the Board of Tax Appeals for a redetermination of the deficiency under

the provisions of Section 272 of the Internal Revenue Code. (R. 1–3.) The decision of the Board of Tax Appeals sustaining the deficiency was entered January 30, 1942. (R. 104–105.) The case is brought to this Court by petition for review filed April 23, 1942 (R. 105–108), pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

QUESTION PRESENTED

A single question is presented—whether the taxpayer was a business league within the provisions of Section 101 (7) of the Revenue Act of 1938 and, accordingly, exempt from income and excess profits taxes during the year 1938.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1938, c. 289, 52 Stat. 447:

> SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS.
>
> The following organizations shall be exempt from taxation under this title—
>
> * * * * *
>
> (7) Business leagues, chambers of commerce, real-estate boards, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual;
>
> * * * * *

Treasury Regulations 101, promulgated under the Revenue Act of 1938:

> ART. 101 (7)–1. *Business leagues, chambers of commerce, real estate boards, and boards of trade.*—A business league is an association of

persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit even though the business is conducted on a cooperative basis or produces only sufficient income to be self-sustaining, is not a business league. An association engaged in furnishing information to prospective investors, to enable them to make sound investments, is not a business league, since its activities do not further any common business interest even though all of its income is devoted to the purpose stated. A stock exchange is not a business league, a chamber of commerce, or a board of trade within the meaning of the law and is not exempt from tax.

STATEMENT

The facts as found by the Board of Tax Appeals (R. 93–103) and as established by the undisputed evidence in brief are as follows:

The taxpayer was formed in 1924 as a voluntary association of apartment owners under the name of Apartment Operators Association. (R. 49.) On November 3, 1937, it was incorporated under the laws of the State of Washington relating to non-profit cor-

porations. Its membership is limited to owners of three or more rental units of a certain classification in Seattle and King County, Washington. (R. 56, 93.) It has no capital stock and it pays no dividends. (R. 93.)

The objects and purposes for which taxpayer was formed are stated in its articles of incorporation, as follows (R. 93–94):

> (a) To provide a mutual benefit organization not operated for profit, for the purpose of gathering and distributing facts, data, and information relative to the ownership, operation, and general conduct of apartment houses and the apartment house business in general, for the use and benefits of its members and for public dissemination.
>
> (b) To provide a meeting place, office and other facilities which are deemed necessary or desirable in the handling of its affairs and for use and benefit of its members.
>
> (c) To handle goods, wares and merchandise required by its members, and to render service and counsel, and assistance to its members, and generally to assist them in control of their financial and economic interests and stabilization of the industry.
>
> (d) To own, operate, publish, manage and distribute any publication deemed advisable, and particularly the magazine known as the "Apartment Journal" in accordance with the law governing such publications, and in connection therewith to employ agents to conduct and handle the same, sell advertising space therein, and do all things deemed necessary or expedient in connection therewith.

(e) To encourage and assist in the organization of apartment house owners and operators in the State of Washington.

The following summary of provisions of articles of the by-laws are illustrative of the functions of the taxpayer as set out in its articles of incorporation:

1. A legislative committee is provided for to keep in touch with legislative bodies of the city, county and state, in order to protect the best interests of the members of the apartment industry. (Art. XII, Sec. 5 (a); R. 96–97.)

2. A rental committee is provided for to keep in touch with the "rental situation so that the members may be kept advised of the true condition as to vacancies, rentals, the trend of supply and demand, and all such information as may be of value to the Association in rendering accurate service to its members." (Art. XII, Sec. 5 (e); R. 97.)

3. A supplies and services committee is provided for to supervise supplies furnished and services rendered to members, and to fix prices thereof, subject to the approval of the board of trustees. (Art. XII, Sec. 5 (h); R. 97.)

4. An official publication of the taxpayer is established and known as "Apartment Journal," to be managed by the board of trustees, under the direct management of the executive secretary to be known as the managing editor. (Art. XIII; R. 98.)

5. It is provided that the board of trustees, which has power to authorize the purchase and otherwise acquire "any and all kinds of supplies, goods, wares, and

merchandise used or useful by its members in connection with their business, consolidating such purchases in their discretion in quantity purchases, in harmony with members' requirements, or orders and withdrawals therefrom, for the purpose of obtaining wholesale prices and reductions; and to dispose of, handle, transport, store, warehouse, sell and deliver same to the members of this Association, as required by them; and to fix the price thereof and charge and collect of such member such cost of same plus a service charge or fee for so handling the same; and to set aside any profits derived therefrom in a surplus fund to be established by resolution of the Board of Trustees." (Art. XV, Sec. 1; R. 98–99.)

6. It is provided that the association will employ and furnish to its members the services of "individuals for apartment shopping, and any other service for which there is deemed a general or pressing demand, at the actual cost of such service plus a service charge therefor to be fixed by resolution of the Board of Trustees." (Art. XV, Sec. 2; R. 99.)

7. It is provided that there shall be a labor relations committee for "the purpose of dealing with labor unions and settling labor disputes between the members and their employees." The committee is to negotiate with labor unions for agreements covering uniform practices and standards of hours and wages applicable to the different types of buildings and employment in the apartment industry. The committee is also to hear disputes and complaints arising between any member and employee. (Art. XVII; R. 100–101.)

The articles of incorporation provide in Section VII (j) that the corporation shall have power (R. 95):

> To establish, accumulate, and operate a surplus fund from any of its operations, including: Members' fees, charges and dues; and services rendered members and supplies purchased and handled for its members; and to distribute such fund to members in accordance with the provisions of its By-laws.

The counterpart of this provision in the by-laws is contained in Article XVI, which provides that the board of trustees by resolution may establish a surplus fund, into which shall be paid and deposited (R. 100)—

> all monies and monetary profits received from fees, dues, service charges, journal advertising and from any other source or sources which are not deemed necessary to retain in the commercial banking account of the Association to meet the operating expenses thereof and for working capital. Such surplus fund shall be jointly owned by all of the members of the Association as such in good standing, but such funds shall be subject to the exclusive control, use, disposal and disbursement by the Board of Trustees.

Section 2 of this article provides (R. 100):

> In its discretion, the Board of Trustees may use this fund or any part thereof to acquire and establish an office, meeting place, and other facilities for the handling of the business of the Association, and otherwise for the use and benefits of its members, and may distribute such fund, or any part thereof, pro-rata to the members of the Association in good standing, con-

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tributing to the source of such fund through the purchase of supplies handled or contracted for by the Association.

The Board of Tax Appeals found that the taxpayer exercised "substantially all the foregoing functions" and specifically enumerated the following (R. 101–102):

1. It acted as a clearing house for information about tenants and about the operation of apartment houses and legislation affecting the business.

2. It gave counsel and advice and did what it could to promote the common welfare of the members.

3. It printed specially designed forms such as rent receipts and rental agreements on its own machine and sold them to members at cost, plus a small margin. The price was less than a member would ordinarily pay if he were to have the forms printed independently.

4. It secured information about prices and bought articles such as electric light bulbs and other electrical equipment in larger quantities and at lower units prices than the members would ordinarily pay, and sold them to the members at prices slightly above cost. In 1938 it bought at a 36% discount and sold to its members at 32%.

5. In 1938 (the taxable year) it published a journal and distributed it among its members. This method of disseminating information was less expensive than by letter or pamphlet. The journal carried advertising of apartment supply houses, light and power and telephone companies. The Board found that the journal did not pay for itself and was discontinued in 1939. The record indicates that an important reason

for discontinuing the journal was the belief that its publication might subject the taxpayer to income tax liability. (R. 16.) While the journal did not pay for itself, as the Board found, it did save the taxpayer a considerable sum of money in the dissemination of information to its members, as indicated by the fact that the dues were greatly increased after the discontinuance of the journal, due to the large increase in postage and the number of letter which were sent by the taxpayer containing information which previously had been contained in the journal. (R. 29.)

6. It represented members in labor disputes, and negotiations and hearings were held in its rooms.

The Board found that the taxpayer has no purpose or intention of making a profit but that it strives to achieve a small surplus to assure its continuance, and that it maintains a general fund comprising receipts from all sources, which include dues, sales and advertising receipts, from which it pays all expenses. During 1938 the fund increased but has remained stationary since. (R. 102.)

The taxpayer's 1938 return indicates gross receipts of $10,814.17, consisting of dues, $6,943, journal, $2,519.09, and merchandise sales, $1,352.08; its expenses were $9,873.08, comprised of general expenses, $3,641.96, journal, $4,604.96, and merchandise purchases and expenses, $1,626.16. (R. 102–103.)

SUMMARY OF ARGUMENT

The settled tests of whether a non-profit trade association is a tax exempt business league are (1) whether the association carries on a regular business of

a kind ordinarily carried on for profit or performs particular services for individual persons, and (2) whether any of the net profits of the organization inure to the benefit of individual members.

The taxpayer here regularly carried on numerous activities of a kind ordinarily carried on for profit or which constituted services for individual persons. These included printing forms, purchasing and reselling supplies, arranging for direct purchases by members at a discount, supplying credit information, supplying an apartment shopping service, settling controversies between individual members and labor unions, and publishing and distributing a journal. Some of these activities are of a kind ordinarily carried on for profit and all of them contained the common factor of service to the taxpayer's members as a convenience or economy in their business. Together they formed the major phases of the taxpayer's operations and carried out a formally announced and continuing object to improve the condition of apartment owners individually. They were not, therefore, incidental. Moreover, the Board of Tax Appeals' various findings concerning the aforesaid specific activities of a non-exempt nature engaged in by the taxpayer together with its failure to find more than one non-exempt activity are findings of fact binding on this Court since they are supported by substantial evidence and are not based on an erroneous rule of law.

Since taxpayer is engaged in a business of a kind normally carried on for profit and in performing services for individual members, it is unnecessary for the

Court to decide whether the net profits inured to the benefit of individual members. The failure of the taxpayer to bring himself within one of the categories, even though he is within the other, defeats exemption. But here the taxpayer is within neither. Net profits inured to the benefit of individual members, since earnings were available for use in advancing the purposes of the association which directly benefit the members individually, and the surplus fund could be distributed to the members at any time.

ARGUMENT

The taxpayer is not exempt from income and excess profits taxes under Section 101 (7) of the Revenue Act of 1938

Section 101 (7) of the Revenue Act of 1938 provides for the exemption from taxation of:

> Business leagues, chambers of commerce, real-estate boards, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual;

The taxpayer claims exemption under this section as a business league. (Br. 9.)

The decisions of this and other federal courts make clear that the taxpayer may qualify as an exempt organization only if (1) it is not organized for profit, (2) it is not engaged in a regular business of a kind ordinarily carried on for profit and if it is semi-civic in nature, having for its primary purpose the advancement of the interests of the community or improvement of the conditions and standards of a particular trade or business, rather than the convenience or economic

interests of its members, and (3) its net earnings do not inure to the benefit of its members. *Retailers Credit Ass'n* v. *Commissioner,* 90 F. 2d 47 (C.C.A. 9th); *Northwestern Municipal Ass'n* v. *United States,* 99 F. 2d 460 (C.C.A. 8th); *Uniform Printing & S. Co.* v. *Commissioner,* 33 F. 2d 445 (C.C.A. 7th), certiorari denied, 280 U. S. 591; *Produce Exchange Stock Clearing Ass'n* v. *Helvering,* 71 F. 2d 142 (C.C.A. 2d); *Park West-Riverside Associates, Inc.* v. *Commissioner,* 110 F. 2d 1022 (C.C.A. 2d), affirming *per curiam* unreported memorandum opinion of the Board of Tax Appeals dated June 2, 1939; *Northwestern Jobbers' Credit Bureau* v. *Commissioner,* 37 F. 2d 880 (C.C.A. 8th); *Durham Merchant's Ass'n* v. *United States,* 34 F. Supp. 71 (N.C.). The taxpayer argues, however, that there are but two conjunctive requirements for exemption: (1) it [the taxpayer] "must not be organized for profit," and (2) "no part of its net earnings must inure to the benefit of any private share holder or individual." (Br. 10.) In making this statement counsel has ignored the provisions of Article 101 (7)–1 of Treasury Regulations 101, promulgated under the 1938 Act:

> A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus its activities should be directed to the improvement of business conditions of one or more lines

> of business as distinguished from the performance of particular services for individual persons. An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit even though the business is conducted on a cooperative basis or produces only sufficient income to be self-sustaining, is not a business league.

These provisions have stood in substantially identical form in previous regulations and through repeated reenactments of the statute, and have been uniformly accorded the force of law by this and other Circuit Courts of Appeals. *Retailers Credit Ass'n* v. *Commissioner, supra; Uniform Printing & S. Co.* v. *Commissioner, supra,* p. 447; *Sunset Scavenger Co.* v. *Commissioner,* 84 F. 2d 453, 457 (C. C. A. 9th); *Park West-Riverside Associates, Inc.* v. *Commissioner, supra.*

The regulation thus expresses one of the tests enunciated above and the one ignored by taxpayer's two requirements for exemption. An organization to be exempt must be engaged in the improvement of business conditions of one or more lines of business; it must not perform services for individual persons, and it must not engage in a regular business of a kind normally carried on for profit.

Counsel for taxpayer has devoted a large portion of his brief to arguing that since the taxpayer was organized as a non-profit corporation under the statutes of the State of Washington (Br. 10)—

> It logically follows that unless the petitioner violates the very statute which breathes life into it, it cannot engage in a profit making enterprise, nor distribute any net earnings to its members.

Counsel, in other words, advances the novel proposition that if the taxpayer has abided by the terms of the Washington statute creating it, it is exempt as a business league under the Revenue Act. The position is so patently erroneous that extended discussion is unnecessary. As was pointed out at the beginning of the argument, there are three conjunctive tests of exemption under Section 101 (7). Of these three, one is that the organization must not be organized for profit. A corporation organized not for profit must still establish that it can meet the other two. Counsel's statement that the taxpayer "cannot engage in a profit making enterprise, nor distribute any net earnings to its members" (Br. 10) without violating the Washington statute may very well be correct. These are not, however, the tests of exemption under Section 101 (7). Thus, Article 101 (7)–1 of Treasury Regulations 101 quoted above specifically provides that—

> An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit even though the business is conducted on a cooperative basis or produces *only sufficient income to be self-sustaining, is not a business league.* (Italics supplied.)

Moreover, counsel states (Br. 11) that Section 3893 of the Washington Code expressly contemplates the furnishing of supplies to members, and the formation and distribution of a surplus fund. Article 101 (7)–1 of the Regulations, however, specifically provides that an exempt organization may *not* render services to individuals. Furthermore, the distribution of net earnings through the distribution of a surplus fund is "net

earnings'' inuring ''to the benefit of any * * * individual'' as will be developed in part B of the argument. Clearly, therefore, the Washington statute specifically contemplates activities of a corporation directly contrary to the express provisions of Section 101 (7) of the Revenue Act of 1938 and Article 101 (7)–1 of Treasury Regulations 101, promulgated thereunder.

A. The taxpayer is predominantly engaged in businesses of a kind normally carried on for profit and in performing services for individuals so that it is not an exempt business league within Section 101 (7)

No question arises as to the taxpayer being in form a business league. But as this Court said in *Retailers Credit Ass'n* v. *Commissioner, supra* (p. 50), ''All business leagues are not exempt, however. Only those having particular purposes, which do not have the prohibited purposes, *and which operate in the prescribed way are exempt.''* (Italics supplied.) Article 101 (7)–1 of Treasury Regulations 101, as noted *supra,* declares that the prohibited purposes are ''to engage in a regular business of a kind ordinarily carried on for profit'' and ''the performance of particular services for individual persons.'' This interpretation has been consistently applied as the test of an exempt business league. *Retailers Credit Ass'n* v. *Commissioner, supra; Produce Exchange Stock Clearing Ass'n* v. *Helvering, supra; Park West-Riverside Associates, Inc.* v. *Commissioner, supra.*

The *Produce Exchange* case involved a wholly owned subsidiary of the New York Produce Exchange, which was formed in order to aid persons trading in securities

listed on the Produce Exchange to clear their transactions. For the clearing service rendered, a small fixed charge was made. The amount of the charge was originally fixed with a view to just covering expenses, but in the taxable year receipts had exceeded expenditures by a considerable amount. In holding that the taxpayer was not exempt from tax on this income as a "business league", the Court stated (pp. 143):

> The numerous subdivisions of section 103 of the Revenue Act of 1928 (26 USCA § 2103) and the corresponding provisions in the earlier acts, specify organizations which, in the great majority of instances, are evidently granted exemption because of the benefit to be derived by the public from their activities. Cf. *Trinidad* v. *Sagrada Orden,* 263 U. S. 578, 581, 44 S. Ct. 204, 68 L. Ed. 458. There is reason why these should be favored, but none is apparent for exempting an association which merely serves each member as a convenience or economy in his business. This is the distinction which the Board of Tax Appeals and the courts have taken in applying the provision in question to somewhat analogous situations.

Article 101 (7)–1 of Treasury Regulations 101 specifically expresses these tests as follows:

> Thus its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons.

The regulation also provides that an exempt business league should promote common business interests and

not "engage in a regular business of a kind normally carried on for profit".

Applying these tests to the activities of the taxpayer disclosed by the record, which were also formally announced objectives expressed in its articles of incorporation and by-laws, it is apparent that at least seven distinct types of activities are of a character to exclude the taxpayer from tax exemption. Printing forms and selling them (R. 101) is a business normally carried on by printing establishments. Purchasing such supplies as electric light bulbs and other electrical equipment, and stationery for resale (R. 101–102) is a business regularly carried on for profit by retail stores. Arrangements made by the taxpayer, pursuant to which individual members purchased various supplies directly from a seller at a discount (R. 102), served the convenience and economic interests of individual members of the taxpayer. Supplying information concerning the credit or conduct of tenants (R. 40, 101) is a business of a type normally carried on for profit by credit-reporting organizations. *Retailers Credit Ass'n* v. *Commissioner, supra; Park West-Riverside Associates, Inc.* v. *Commissioner, supra.* Furnishing services of "individuals for apartment shopping" (R. 99) is a business normally carried on for profit. The settlement of controversies between individual members of the taxpayer and labor unions (R. 102) is a convenience to such members. The taxpayer's president testified to this when he said: "Also, if any individual member, or any member of the union, have a misunderstanding, we have a special committee that handles that difficulty,

and it is of very great service to the members." (R. 41.) Publishing and distributing a journal to members (R. 102) served the convenience and economic interest of members. It was testified that the dues were "greatly increased" due to the loss of savings in operations upon discontinuance of the journal after the taxable year. (R. 29.)

All of these activities thus served the convenience and economic interests of individual members, and some constituted a continuing business of a kind normally carried on for profit.

It is true that the taxpayer had other formally stated objectives in its by-laws and articles of incorporation, such as promomting standards and ethical business practices, assisting in the formation of similar associations in other cities of the State of Washington, the promotion of efficiency in the conduct of the members' business, and the elimination of unwise and unfair business practices which may properly be characterized as semi-civic in nature and, therefore, activities of an exempt nature. The applicable principle in determining whether an organization is exempt when there are both exempt and nonexempt activities was stated by this Court in *Retailers Credit Ass'n* v. *Commissioner, supra,* pp. 51, 52, as whether the purpose " 'to engage in a regular business of a kind ordinarily carried on for a profit.' . . . is only incidental or subordinate to the main or principal purposes required by statute . . ." In making this determination "each case must stand on its own facts. No rigid rules may be established as a gauge." In that case it was held

that the supplying of credit information to members and the providing of a collection service was not incidental to the exempt activity of "education of prospective purchasers to base their purchases upon ability to pay therefor."

Webster's New International Dictionary defines the word "incidental" as "Happening as a chance or undesigned feature of something else; casual; hence, not of prime concern; subordinate; collateral; as, an *incidental* conversation; *incidental* expenses. * * *" Certainly it can not be said that the continuing occupation by the taxpayer with printing and selling forms, purchasing supplies for resale to members, arranging for purchases at a discount directly by members, supplying information concerning credit or conduct of tenants, furnishing apartment shopping services and settling controversies of individual members with labor unions, were chance or undesigned features of the association. If anything was incidental it was such objectives as the promotion of standards and ethical business practices and assisting in the formation of similar organizations in other cities of the State of Washington. Whether the nonexempt objectives are "incidental" must also be interpreted in view of the familiar doctrine that a statute creating an exemption must be strictly construed and any doubt must be resolved in favor of the taxing power. *Retailers Credit Ass'n* v. *Commissioner, supra.* This is, however, probably not a situation in which the "incidental" concept need be applied because the taxpayer concerned itself overwhelmingly with nonexempt ac-

tivities. Thus, the Board of Tax Appeals in its findings of fact, while stating that the taxpayer exercised "substantially all" the functions provided for in the articles and by-laws, went on to list the functions which were actually exercised and included the aforelisted nonexempt functions (R. 101–102), but included only one activity which can be classified as exempt. This was in the Board's language, "it [the taxpayer] gave counsel and advice, and did what it could to promote the common welfare of the members." (R. 101.) The only possible interpretation which can, therefore, be put on the Board's finding is that those activities which we argue are of a nonexempt character were the predominant activities of the taxpayer. Moreover, the characterization by the Board, in its opinion (R. 103), of the taxpayer as a "cooperative buying organization" had implicit in it inevitably that one of the nonexempt activities—buying at a discount and selling to members at less than they would otherwise pay—was a major activity. In any event there is nothing in the Board's finding, nor could there be on the record, to indicate how important the exempt activities were. And since a deduction is a matter of legislative grace, the burden is on the taxpayer to bring himself clearly within it. *New Colonial Co.* v. *Helvering,* 292 U. S. 435. Manifestly the taxpayer has failed in this burden.

These findings are supported by substantial evidence and therefore are binding on this Court. *Commissioner* v. *Chicago Graphic Arts F.,* 128 F. 2d 424 (C. C. A. 7th). See also *Palmer* v. *Commissioner,* 302 U. S. 63, 70; *Helvering* v. *Nat. Grocery Co.,* 304 U. S. 282, 294;

Helvering v. *Kehoe,* 309 U. S. 277. In the *Chicago Graphic Arts* case the court felt itself bound by the Board's finding that those activities of the taxpayer which were of a kind ordinarily carried on for profit were incidental to its main or principal purpose.

The Board's conclusion (R. 103) that the taxpayer was a "cooperative buying organization, withholding a margin, however small" is clearly correct. As the Board stated—

> Such cooperatives are not among the exempt organizations of the statute, as are farmers' cooperatives, which buy supplies and turn them over to members at actual cost plus necessary expenses. (Sec. 101 (12).

Analogous reasoning appears in *National Outdoor Advertising Bureau* v. *Helvering,* 89 F. 2d 878, 880 (C. C. A. 2d), where the court said—

> Obviously, Congress did not mean to exempt all marketing or buying cooperative associations; it would not have limited its intent so specifically, and we need not consider whether the exemption, if so construed, is unfairly discriminatory. The Seventh and Ninth Circuits have denied the exemption to corporations no further removed from farmers than the "Bureau," and it seems to us that the point is really not debatable. *Garden Homes* v. *Commissioner,* 64 F. (2d) 593, 596 (C. C. A. 7); *Sunset Scavenger Co.* v. *Commissioner,* 84 F. (2d) 453, 455 (C. C. A. 9).

B. The net earnings of the taxpayer inured to the benefit of its members

Since the requirements for exemption that the taxpayer not engage in a business of a type normally car-

ried on for profit, and no part of its net earnings inure to the benefit of individual members are conjunctive, it is not necessary that the Court find that the net earnings of taxpayer did inure to the benefit of individual members in order to deny exemption. This Court in the *Retailers Credit Association* case, *supra* (p. 52), said—

> All of the conditions regarding the operation are self-explanatory, except as to when net earnings inure to the benefit of private shareholders or individuals * * *.
>
> It is unnecessary to apply these rules in the instant case, because we have already held petitioner is not exempt.

Section 103 (7) denied exemption if any part of the organization's net earnings "inures to the benefit of any private shareholder or individual." Even if, therefore, the taxpayer's activities were not such as to deny exemption, exemption must be denied because net profits inure to the benefit of individual members. *Northwestern Jobbers' Credit Bureau* v. *Commissioner,* 37 F. 2d 880 (C. C. A. 8th); *Uniform Printing & Supply Co.* v. *Commissioner, supra; Fort Worth Grain & Cotton Exchange* v. *Commissioner,* 27 B. T. A. 983. In these cases exemption was denied to organizations of the same private nature as taxpayer on the ground that their net earnings, although not distributed by way of dividends, were available for use in advancing the purposes of the association and therefore inured to the benefit of the individual members of the organization.

Under the rule of these decisions, taxpayer is not

entitled to exemption. Its net earnings, consisting of the excess of dues over expenses, constituted a surplus fund which was available for use in future years to defray part of the cost of rendering the same services to petitioner's members as petitioner rendered during the taxable year. As we have shown, the services directly benefited the business of petitioner's members and consequently funds available to pay for such services inure directly to the benefit of those members.

Moreover, an additional factor is present here that was not in the above cases. Here as the Board specifically found (R. 103) according to Article XVI of the by-laws, the surplus fund may be distributed among the members. Counsel for the taxpayer states on this point (Br. 21)—

> As we understand the theory of the Board of Tax Appeals, any surplus *might be* distributed to members, but the fact still remains, it was not.

Manifestly, if it is sufficient that a surplus fund merely be available to defray part of the costs of rendering the same services to the taxpayer's members as were rendered during the taxable year to be under the above decisions, profit inuring to the benefit of individual members, the additional fact that the surplus fund can, at any time, be distributed to individual members in cash constitutes an *a fortiori* situation.

There remains to be considered the following "issue" listed by taxpayer's counsel (Br. 2):

> 3. Are dues paid by members to defray expenses of a business league, income within the meaning of the Internal Revenue Statute?

This contention was not made before the Board of Tax Appeals and was not referred to in the assignments of error (R. 109) nor in the statement of "Points To Be Relied On Upon Appeal" (R. 111–112) to which the hearing before this Court is confined by its Rule 19 (6). *Bank of America Nat. T. & Sav. Ass'n* v. *Commissioner,* 126 F. 2d 48 (C. C. A. 9th).

Moreover, apart from procedural deficiencies, this contention is without merit. Taxpayer's counsel develops this proposition as follows (Br. 20–21):

> By every rule of mathematics and reason, any surplus must come from the membership dues. Under what theory can these dues be treated as profit? The answer is, obviously, they can not. They were treated and should be treated merely as accumulated funds for the purpose of carrying on the business league.

Counsel has obviously confused the type of operations which are relevant to determining whether taxpayer is an exempt corporation with what constitutes taxable income to a nonexempt organization. Thus the Supreme Court in *Trinidad* v. *Sagrada Orden,* 263 U. S. 578, 581, in holding that the organization was exempt under Section 101 (6) [1] stated:

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[1] In *Waynesboro Manufacturers Association* v. *Commissioner,* 1 B. T. A. 911, the Board said (p. 914):

> We mention this parallel because the Supreme Court has considered subdivision (6), and what it has said about the statutory exemption in the case of corporations which are implicitly not organized for profit applies to the organizations of subdivision (7) which are explicitly so. * * * Cf. also *Produce Exchange Stock Clearing Ass'n, Inc.* v. *Helvering, supra.*

> Whether the contention [that the income from properties devoted exclusively to exempt activities defeats the exemption] is well taken turns primarily on the meaning of the excepting clause, before quoted from the taxing act. Two matters apparent on the face of the clause go far towards settling its meaning. * * * Next, *it says nothing about the source of the income, but makes the destination the ultimate test of exemption.* [Italics added.]

Dues of a nonexempt association are clearly taxable income. *United Retail Grocers Association* v. *Commissioner,* 19 B. T. A. 1016; *Employees' Benefit Assn. of Amer. Steel Foundries* v. *Commissioner,* 14 B. T. A. 1166; *Pontiac Employees Mutual Benefit Assn.* v. *Commissioner,* 15 B. T. A. 74; *Park West-Riverside Associates, Inc.* v. *Commissioner, supra; Commissioner* v. *Chicago Graphic Arts, supra.* In the last two cases the deficiency assessed by the Commissioner was based in large part on revenue consisting of members' dues and the Court did not question in either case what apparently has always been conceded, that such dues are income. In the *Park West-Riverside* case, the organization was held not exempt so that the tax was required to be paid on dues, and in the *Chicago Graphic Arts* case, the business league was held exempt and therefore the income consisting of dues was exempt because the organization was, and not because dues paid to a nonexempt association are not income. In each of the above cases decided by the Board of Tax Appeals, the taxpayer contended that dues were not income and in each case it was held that they were.

Counsel's argument that dues are not "profit" and therefore not taxable is without merit. The statute does not tax "profit" but rather "net income," which is defined in Section 21 as gross income computed under Section 22 less deductions allowed by Section 23. His assertion that the dues are "accumulated funds" and therefore not taxable is equally without merit. That part of the dues became "accumulated funds" merely describes their use. This, of course, has no relevance to a determination of whether it was income when received any more than to say that money coming to a corporation because of the sale of merchandise cannot be income because the recipient put it into surplus. Taxpayer's members paid dues in order to receive the services which the taxpayer could render. Taxpayer has advanced no valid basis on which to exclude dues from income, nor is there any.

The cases which counsel for the taxpayer cites and which deal with the question of whether an organization is exempt under one subsection or another of Section 101 are all distinguishable on their facts. *Crooks* v. *Kansas City Hay Dealers' Assn,* 37 F. 2d 83 (C. C. A. 8th) (Br. 12–13); *Santee Club* v. *White,* 87 F. 2d 5 (C. C. A. 1st) (Br. 14); *Waynesboro Manufacturers Association* v. *Commissioner, supra* (Br. 15); *King County Insurance Association* v. *Commissioner,* 37 B. T. A. 288 (Br. 16–17).

As this Court pointed out in the *Retailers Credit Association* case, *supra, Crooks* v. *Kansas City Hay Dealers' Assn, supra,* is distinguishable because (p. 51)—

> exemption was not denied, where the purpose to engage in a regular business of a kind ordinarily carried on for profit was only incidental to the main and principal purpose.

Indeed, in examining the provisions of the association's constitution in the *Hay Dealers'* case it is difficult to discover any objectives that served the convenience and economic benefit of individual members or constituted a regular business of a kind normally carried on for profit. In the *Santee Club* case counsel relies on the language of the court that (p. 7) "A single transaction of incidental character does not constitute engaging in business." That the language is not applicable to the facts in the case at bar is demonstrated by the fact that the taxpayer is engaged not in one but in numerous kinds of businesses, transacted not once but continuously. The question in *Waynesboro Manufacturers Association* was not, as here, whether the organization's objectives were such as to deny exemption, but was whether the organization was organized not for profit (which is conceded here) and whether any part of the net earnings inured to the benefit of any individual. The only similar issue, therefore, is the question of whether net earnings inured to the benefit of individuals, and on this point the case is not helpful because it did not involve a surplus fund that could be distributed to individual members and the organization was not performing services for individuals on which the expenditure of net earnings could constitute earnings inuring to the benefit of individuals.

The last exempt organization case cited by the taxpayer was *King County Insurance Association, supra.* The Board in that case held (p. 291) that—

> There can be no question but that the petitioner qualifies as a business league exempt from income tax * * * unless it is barred * * * by reason of the fact that it acted as agent in writing insurance policies on so-called "public business."

The Board found that members waived their commissions on insurance policies on properties owned by a municipality in order to provide additional revenue to meet the association's expenses which were incurred entirely because of exempt activities. There is therefore no similarity between that case and the one at bar because there all activities were of the exempt type, whereas here almost all of them are of a nonexempt nature.

Finally, counsel relies on *Inland Empire Etc.* v. *Dept. Pub. Service,* 199 Wash. 527, 92 P. (2d) 258; and *State Ex. Rel. Silver Lake R. & L. Co.* v. *Pub. S. Comm.,* 117 Wash. 453, 201 Pac. 765. (Br. 18–19.) Reliance on these cases is based on counsel's erroneous assumption discussed, *supra,* that a corporation organized under the State of Washington nonprofit corporation act is, as such, exempt under Section 101 (7) of the Revenue Act. The second paragraph quoted by counsel from the opinion in the *Inland Empire* case indicates that the test of compliance with the Washington statute and with Section 101 (7) is in at least one respect diametrically opposed. This quotation is as follows (p. 540):

The service, which is supplied only to members, is at cost, since surplus receipts are returned ratably according to the amount of each member's consumption. There is complete identity of interest between the corporate agency supplying the service and the persons who are being served. It is a league of individuals associated together in corporate form for the sole purpose of producing and procuring for themselves a needed service at cost. In short, so far as the record before us indicates, it is not a public service corporation.

CONCLUSION

The decision of the Board of Tax Appeals should be affirmed.

Respectfully submitted,

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